FISCAL NOTE

Bill #: SB0224

Title: Sales tax on goods for property tax relief, universities, and teacher pay

Primary Sponsor: Kitzenberg, S

Status: As Introduced

Sponsor signature Date

Chuck Swysgood, Budget Director Date

Fiscal Summary

	FY 2004 Difference	FY 2005 Difference
Expenditures:		
General Fund	$8,713,365	$2,582,844
State Special Revenue	$0	$49,500,000
Revenue:		
General Fund	$76,956,500	$89,747,500
State Special Revenue	$76,956,500	$158,847,500
Net Impact on General Fund Balance:	$68,243,135	$87,164,656

☒ Significant Local Gov. Impact
☐ Included in the Executive Budget
☐ Dedicated Revenue Form Attached
☒ Technical Concerns
☒ Significant Long-Term Impacts
☒ Needs to be included in HB 2

Fiscal Analysis

ASSUMPTIONS:

Department of Revenue

Sales Tax

1. Beginning January 1, 2004, this bill would impose a sales and use tax on tangible personal property, including utilities and canned software, with the following exceptions:
   a. Sales for resale or lease
   b. Sales by or to federal, state local or tribal governments, other than utility sales by governments,
   c. Groceries
   d. Drugs, medical and mobility equipment
   e. Motor vehicles that must be licensed
   f. Motor fuels
   g. Occasional sales, including non-profit fundraisers
   h. Agricultural inputs and unprocessed agricultural products
   i. Minerals, except jewelry and fuels that are used directly
   j. Oil and mining chemicals and oil and mining inputs that must be abandoned in place.

   k. Industrial inputs that will become part of a manufactured product, including electricity used in smelting
2. The tax would be in effect for half of FY 2004. Taxable sales in this six month period would be $4.227 billion. Taxable sales in FY 2005 would be $8.716 billion. Taxable sales would be approximately 10% utilities, 45% consumer goods, 15% prepared food, 5% repair parts, and 25% business equipment.
3. Tax liability would be $169.070 million in FY 2004 (4% x $4.227 billion) and $348.623 million in FY 2005 (4% x $8.716 billion). Noncompliance would be 5%. Vendors would collect $160.617 million in FY 2004 (95% x $169.070 million) and $331.192 million in FY 2005 (95% x $348.623 million).
4. Vendors with taxable sales of less than $30,000 per year would be allowed to retain 5% of collections or $150 each quarter as an administrative allowance (see technical note 3). Vendors with taxable sales of more than $30,000 per year would be allowed to retain the lower of 1.5% of collections or $250 per months. Vendors with taxable sales between $30,000 per year and $5 million per year would retain 1.5% and vendors with taxable sales of more than $5 million per year would retain $250 each month (1.5% x 4% x $5 million per year / 12 months per year = $250).
5. There would be 35,000 vendors collecting the sales tax. Vendors with sales of less than $30,000 per year would collect 0.1% of the tax. They would retain vendor allowances totaling $8,031 in FY 2004 (5% x 0.1% x $160.617 million) and $16,560 in FY 2005 (5% x 0.1% x $331.192 million). Vendors with annual sales between $30,000 and $5 million would collect 60% of the tax. They would retain vendor allowances totaling $1,445,551 in FY 2004 (1.5% x 60% x $160.617 million) and $2,980,725 in FY 2005 (1.5% x 60% x $331.192 million). Vendors with annual sales of more than $5 million would collect 40% of the tax but make up 10% of the vendors. They would retain vendor allowances of $5.250 million in FY 2004 (10% x 35,000 vendors x $250 per month per vendor x 6 months) and $10.500 million in FY 2005 (10% x 35,000 vendors x $250 per month per vendor x 12 months). The total retained for vendor allowances would be $6,703,581 in FY 2004 and $13,497,285 in FY 2005.
6. Net collections would be $153.913 million in FY 2004 ($160.617 million - $6.704 million) and $317.695 million in FY 2005 ($331.192 million - $13.497 million).
7. Revenue from the sales tax would be allocated 50% to the general fund, 25% to a state special revenue account for teachers' salaries, and 25% to a state special revenue account for higher education. In FY 2004, the general fund would receive $76,956,500, the account for teachers' salaries would receive $38,478,250, and the account for higher education would receive $38,478,250. In FY 2005, the general fund would receive $158,847,500, the account for teachers' salaries would receive $79,423,750, and the account for higher education would receive $79,423,750.

<u>Property Tax Credit</u>

8. For purposes of this fiscal note it is assumed that mills levied for local schools would not be impacted by the proposal. The income tax credit applies to mill levied property taxes, the credit does not apply to special improvement district fees.
9. Taxpayers would be allowed a refundable credit against property taxes on property taxes that are paid after January 1, 2004. For purposes of this fiscal note it is assumed that proposal will apply to property taxes *due* after January 1, 2004 (see technical note 4).
10. Total property taxes, for qualifying property, due after January 1, 2004, and paid in calendar year 2004, are estimated to be $177,200,000. It is assumed that all eligible property taxpayers will apply for the credit. The total amount of credit on property taxes paid in calendar year 2004 is $69,100,000 ($177,200,000 x 39%). This credit would be paid to taxpayers in FY 2005.
11. Total property taxes, for qualifying property, due after January 1, 2005, and paid in calendar year 2005, are estimated to be $358,100,000. It is assumed that all eligible property taxpayers will apply for the credit. The total amount of credit on property taxes paid in calendar year 2005 is $139,700,000 ($358,100,000 x 39%). This credit would be paid to taxpayers in FY 2006.

12. Net revenue to the general fund would be $76,956,500 in FY 2004 and $89,747,500 in FY 2005 ($158,847,500 - $69,100,000)

<u>Tax Administration Costs</u>

13. The Department of Revenue would need to acquire a new computer system to administer this new tax. The department anticipates buying off-the-shelf software and having it customized. The total cost for the customized system would be $6,380,382 in FY 2004, including $74,426 for equipment. Ongoing maintenance costs would be $220,000 each year.
14. The department would need to add 25 additional FTE to process registrations and returns. The department would add 20 FTE for compliance work in FY 2004 and an additional 11 FTE in FY 2005. These 56 additional FTE would require an additional 2 FTE for department support functions. The additional cost for personnel, including benefits would be $1,285,888 in FY 2004 and $1,877,659 in FY 2005. Costs for desks, computers and other equipment for these new employees would be $297,785 in FY 2004 and $103,085 in FY 2005.
15. Startup and operating costs for developing and processing forms and auditing vendors would be $327,418 in FY 2004 and $286,208 in FY 2005.

Montana University System

16. Section 60.1(a) allocates 25% to a state special revenue account for higher education for support, maintenance and improvement. Based on projected net collections, the University System would receive $38.48 million FY 2004 and $79.42 million in FY 2005. No appropriation or allocation is made to the MUS so no expenditure is shown in this fiscal note.

Office of Public Instruction

17. SB 224 allocates 25% of the revenue from the sales and use tax to the state special revenue fund for statewide public school teachers' and specialists' salaries. The legislation requires the state to make payments to teachers and specialists based on their number of years of service and level of education.
18. Based on school district personnel assignment reports submitted to the Office of Public Instruction in FY 2003, there are 11,153 FTE teachers and specialists (i.e. guidance counselors and librarians).
19. SB 224 establishes a 15-step pay schedule for all Montana public school teachers and specialists. The schedules steps are "stair-cased" so that fewer steps are provided at the lower end of the educational attainment matrix and more steps are provided at the upper ranges.
20. SB 224 establishes 10 educational attainment lanes ranging from BA to BA+90 semester credits.
21. The index value of each step or lane increment in SB 224's salary structure is 3% (i.e. each step is worth 3% more than the lane value to its immediate left.)
22. SB 224 requires the state to pay the difference between the district's current base salary and the minimum base salary established in the proposal (see technical note 8).
23. It is estimated that the average starting salary of Montana teachers is $23,062 for first-class school districts; $21,380 for second-class school districts; and $20,314 for third-class school districts. (MEA-MFT). Sixty percent of the teachers are in first-class school districts. On average, school districts are paying teachers and specialists in FY 2003, 88.55% of the statewide salary matrix established in SB 224.
24. Districts will increase salaries by 3% per year.
25. The CPI will increase by 2.3% from December 2002 to December 2003.
26. School districts spent $643.475 million on salaries for school employees in FY 2002. Of this amount, 52% or $334.607 million was spent on salaries for teachers and specialists. The gap between the amount spent by districts for salaries for teachers and specialists and the schedules in SB 224 is estimated to be $44.564 million for FY 2003. The gap is projected to narrow to $32.5 million by FY 2005 if district salaries into by 3% each year of the 2005 biennium. It is assumed that the state pays the gap or $32.5 million (see technical note 8).

27. Section 63 states "If a collective bargaining agreement establishes a higher base salary than the base established in (1) or (2) (the salary schedule), the state shall pay the base salary established through collective bargaining." This provision would enable districts to bargain high salaries for teachers and not be required to pay the additional salary expense. This cost would pass to the state. It is unknown how much districts would bargain increased teachers salaries under this provision. For the purposes of this fiscal note, it is assumed that districts do not have higher salary schedules than the salary schedule provided and this cost is zero.
28. Section 63, subsection (4)(a) provides for a state-paid 5% longevity increment for teachers and specialists who have completed 20 years of credited service in the Teachers Retirement System. Assuming that 3,000 educators qualify for an average of $2,000 the cost would be $6.0 million per year.
29. Section 63, subsection (4)(b) provides for a state-paid 3% longevity increment for teachers and specialists who have completed 25 years of credited service in the Teachers Retirement System. Assuming that 1,000 educators qualify for these longevity payments, which average $1,200, longevity costs are projected to be $1.2 million per year.
30. Section 63, subsection 5 provides stipends, paid for by the state, to teachers and specialists who hold masters or doctoral degrees, teachers who have achieved national board certification, student teacher advisors, and teachers assigned to a PIR-committee. Combined annual costs for these stipends could exceed $8 million.
31. It is assumed that the Office of Public Instruction will be the state agency designated to make payments to the educators eligible for higher base salaries, longevity increments and stipends under Section 63, subsections (4) and (5). The Teachers Retirement System (TRS) has the data on years of credited service for all TRS members and can provide that information to OPI at no cost to either agency. TRS collects information on total compensation for its members, but does not collect data on the base salary of its members.
32. This increase in teachers' salaries will increase the required contributions to Teachers Retirement System, Medicare, Social Security, and Unemployment expense. These costs will be paid through the district retirement fund. The additional costs will be 15.5% of the increased salary expense. This cost will be shared between county levies and state general fund through guaranteed tax base aid. On average the state share is 25%. The remaining 75% will be paid through increased county levies. The state costs will be $47.7 million times 15.5% times 25% or $1.8 million.
33. OPI does not have any data on the salaries of individual school employees. To develop a secure, automated system for the exchange of payroll information for school employees will require $100,000 in FY2004 for a contract to build the system. OPI will also need 2 FTE (Grade 14 and Grade 16) to manage and process the payment system beginning in FY 2004. The cost of 2 FTE would be $81,892 in each year of the 2005 biennium. Costs for desks, computers, overhead, and other equipment for these new employees would be $20,000 in FY 2004 and $14,000 in FY 2005.

Montana School for the Deaf and Blind

34. SB 224 establishes a statewide teacher salary matrix.
35. Thirty-six (36) staff at Montana School for the Deaf and Blind (MSDB) would be funded from the statewide matrix contained in SB 224.
36. HB 2 salaries and benefits for MSDB staff paid from the teachers salary matrix total $1,513,000 in each year of the 2005 biennium.
37. Total salaries and benefits for MSDB staff funded from the statewide matrix contained in SB 224 are $1,827,000 in FY 2005. Therefore, the additional cost in salaries and benefits from SB 224 over salaries and benefits contained in HB 2 $314,000 in FY 2005.

38. Section (63)(4)(a) and (b) of SB 224 establish longevity increments of 5% for staff with 20 years of service and an additional 3% for staff with 25 years of service. These longevity increments are applied to the base salaries contained in SB 224. The total cost for longevity is $45,767 in FY 2005. This cost is included in the difference between HB 2 and SB 224 noted in item 37 above.
39. Section (63)(5)(a) establishes a $1,000 stipend for staff holding a master's or doctoral degree. Twenty-two (22) staff at MSDB would qualify for this stipend at a total cost of $22,000 in each year of the 2005 biennium. This cost is included in the difference between HB 2 and SB 224 noted in item 37 above.
40. No staff currently qualify for stipends contained in Section (63)(5)(b), (c) and (d).

Department of Corrections

41. The Department of Corrections (DOC) is unable to estimate the fiscal impact to the DOC for stipends that will be awarded to teachers or specialists employed by the DOC.
42. DOC has 34 teaching positions.
43. DOC estimates an educator will receive an average increase of 8.3% in base salary above the current rates stipulated in the Executive Budget or $98,000.

FISCAL IMPACT:

	FY 2004 Difference	FY 2005 Difference
Department of Revenue		
FTE	47.00	58.00
Expenditures:		
Personal Services	$1,285,888	$1,877,659
Operating Expenses	6,853,374	506,208
Equipment	372,211	103,085
TOTAL (General Fund)	$8,511,473	$2,486,952
Office of Public Instruction		
FTE	2.00	2.00
Expenditures:		
Personal Services	$81,892	$81,892
Operating Expenses	120,000	14,000
Local Assistance	0	49,500,000
TOTAL	$201,892	$49,595,892
Montana School for the Deaf and Blind		
Expenditures:		
Personal Services	$0	$314,000
Department of Corrections		
Expenditures:		
Personal Services	$0	$98,000
Grand Total all expenditures	$8,713,365	$52,494,844
Funding of Expenditures:		
General Fund (01) DOR and OPI operating	$8,713,365	$2,582,844

State Special Revenue (02) MUS	0	0
State Special Revenue (02) K-12	0	49,912,000
TOTAL	$8,713,365	$52,494,844
Revenues:		
General Fund (01)	$76,956,500	$89,747,500
State Special Revenue (02) MUS	38,478,250	79,423,750
State Special Revenue (02) K-12	38,478,250	79,423,750
TOTAL	$153,913,000	$248,595,000
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):		
General Fund (01)	$68,243,135	$87,164,656
State Special Revenue (02) MUS	$38,478,250	$79,423,750
State Special Revenue (02) K-12	$38,478,250	$29,511,750

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

1. School district expenditures will increase substantially as a result of the state salary supplements.
2. School districts may shift a portion of their salary costs to the state to the extent district salary increases do not keep up with the growth in SB 224 schedules. This may result in reduced local taxes or increased expenditures on other items by the district.
3. If the district must increase the salaries without the state paying the difference (see technical note 8.) SB 224 would be an unfunded mandate to districts.
4. County taxes will increase by the remaining retirement expense increase (assumption 32.) or $5.5 million.

LONG-RANGE IMPACTS:

Income tax credits claimed in fiscal 2006 would be $139,700,000. Sales tax revenue is projected to grow at 3.1% per year. Sales tax revenue to the general fund would be $163,772,000 (103.1% x $158,847,500). Net revenue to the general fund would be $24,072,000 ($163,771,773 - $139,700,000).

The income tax credit would grow over time at the same rate that the value of residential property grows, which is projected to be 7% per year.

Because the state is required to pay the amount bargained by districts that is above the schedules (Section 63 (3)), salaries above the schedules will grow and will require the state to pay significantly more.

The cost of the K-12 teacher section of this bill is difficult to determine. The actual costs, especially in the long term may be substantially more than indicated in this fiscal note.

TECHNICAL NOTES:

1. This bill imposes a tax on the sale or use of tangible personal property. The following sections appear to be redundant because they exempt sales of items that are not tangible personal property:
    a. Section 15 exempts insurance premiums
    b. Section 16 exempts dividends, interest, securities, and securities brokers fees.
    c. Section 25 exempts the sale or lease of real property or improvements.
    d. Subsections 26(2) and (3) exempt radio transmissions and sale of advertising time.

2. This bill does not impose a tax on rentals or leases. The following sections appear to be redundant because they exempt leases:
    a. Section 25 exempts the lease of real property or improvements.
    b. Sections 28 and 29 exempt the lease or use of property for leasing.
3. Subsection 39(3) allows quarterly filers to retain a vendor allowance of the lesser of 5% of tax liability or $150 each quarter. Section 37(3)(b) allows vendors with average monthly tax liability of less than $100 to file quarterly returns and requires all other vendors to file monthly returns. A vendor with average monthly tax liability of less than $100 would have annual taxable sales of less than $30,000 (4% x $30,000 = $100/month x 12 months). The highest tax liability that a quarterly filer could have in one quarter would be $1,200 for a seasonal business with $30,000 of sales in one quarter. The vendor allowance in this case would be $60 (5% x $1,200). Thus, no quarterly filer could reach the maximum vendor allowance of $150 in Section 39(3).
4. For tax year 2003, 1/2 of the property tax payment is due by November 30, 2003, and 1/2 is due by May 31, 2004. It is possible that some taxpayers may recognize that, by paying the November 30, 2003 property tax payment on January 1, 2004, the benefit of the 39% income tax credit would far outweigh the penalty interest and fee (5/6 of 1% a month and 2% fee) for late payment of property tax. Language in the proposal can be changed to say that the credit is applicable to property taxes *due* after January 1, 2004.
5. The information technology (IT) project required to implement this legislation would require the review and approval of the Chief Information Officer (CIO) as provided for in 2-17-512, MCA.
6. Implementation of this tax will require the department to implement a computer system to automate the administrative requirements of registration, return processing, customer and revenue accounting, and compliance activities. The expenditure will involve millions as shown by this estimate. Projects of this size are normally pursued through a Request For Proposal procedure outlined by the Department of Administration and can routinely take up to 6 months of careful planning and review before selecting a vendor or product that meets the department's requirements. The proposed effective and applicability dates in SB 224 do not appear to allow for the time required to proceed with the normal procurement processes defined in statute. Unless implementation of this act could be identified as an exception to those requirements, the effective date of the act may have to be amended to July 1, 2004 and applicable to sales occurring after June 30, 2004.
7. The statewide salary schedule established in Section 63 applies only to school districts, not to teachers and specialists employed by special education cooperatives.
8. Section 63 implies that the district will pay the entire salary in the salary schedule. Assumptions 22 and 26 assume the state pays the difference between what the districts are estimated to pay and the salary schedule.
9. The Office of Public Instruction will need legislative authority to design and implement a system for tracking salaries for school teachers and specialists as SB 224 will significantly increase the reporting requirements from school districts to the Office of Public Instruction.